



Office of the City Auditor

Amended and Restated Management Services Agreement Between the City of Scottsdale and the Scottsdale Cultural Council Compliance With Section 2.10, Utilities Report No. 0510C.1

October 11, 2007

During the last twenty-four months, the City has allocated and billed the Cultural Council for 50 percent of the cost of electricity, water, and sewer services provided to the SCPA building and the Cultural Council has paid these bills. The City did not allocate the cost of natural gas and, according to staff, the City has historically absorbed the cost of this utility. This report discusses this issue and other areas for improvement.

CITY COUNCIL

Mayor
Mary Manross

Council
Betty Drake
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October 11, 2007

To the Most Honorable Mary Manross, Mayor
and Members of the Scottsdale City Council

Transmitted herewith is Report No. 0510C.1 on the compliance of Section 2.10, Utilities, of the Amended and Restated Management Services Agreement between the City and the Scottsdale Cultural Council.

We would like to thank the staff in the Financial Services Department, Facilities Maintenance Division, Solid Waste Management Division, other City departments, and the Cultural Council for their assistance and cooperation during this audit.

If you need additional information or have any questions, please contact me at 480-312-7756.

Respectfully submitted,

A handwritten signature in cursive script that reads "Cheryl Lu Dreska".

Cheryl Dreska, CPA, CIA, CFE, CGFM, CISA, CISSP
City Auditor

Table of Contents

| | |
|---|----|
| SUMMARY | 1 |
| ACTION PLAN..... | 3 |
| RESULTS | 6 |
| OBJECTIVE, SCOPE, AND METHODOLOGY | 11 |
| BACKGROUND | 13 |
| APPENDIX A – Management Response | 15 |

SUMMARY

An audit of the operational aspects of the Amended and Restated Management Services Agreement (MSA) between the City and the Scottsdale Cultural Council (Cultural Council) dated October 6, 1997, was included on the 2007 City Council approved Audit Plan for the Office of the City Auditor. This report sets out the results of testing undertaken to determine compliance with Section 2.10, Utilities.

We found that:

- The City and the Cultural Council complied with most provisions of Section 2.10.
 - For twenty-four months reviewed, the City billed the Cultural Council for a portion of the cost of electricity and water/sewer service at the Scottsdale Center for the Performing Arts (SCPA) building and the Cultural Council paid these bills.
 - The Cultural Council disposes non-recyclable refuse in a compactor behind a local business and pays one-half of the cost of this service directly to the City so there is no need to allocate this expense.
 - Utility service at the Scottsdale Museum of Contemporary Art (SMoCA) is billed directly to the Cultural Council thereby eliminating any City role in the payment of this expense.
- One provision has not been adhered to. The City does not allocate and bill the Cultural Council for the cost of natural gas service to the SCPA building. This means that the City subsidizes Cultural Council operations an additional amount over the City Council approved annual financial participation agreement.
- The City has not documented the process followed to arrive at the allocation methodology used to bill the Cultural Council for their portion of costs related to water/sewer service. As a result, we could verify the calculation was correct based on the established practice but could not verify that the allocation was based on a logical methodology that was fair and equitable to both parties.
- The City is not consistently reconciling the receivable account used to record the initial amount due from the Cultural Council for the share of electricity. This account is out of balance by almost \$16,000 and has been out of balance for at least three fiscal years.
- The City is not billing for the collection of recyclable materials from City facilities and non-profit organizations. Therefore, there is no invoice to allow allocation of this cost.

The Action Plan, starting on the next page, is a summary of conditions and management's proposed solutions. More detail on the results of audit work can be found in the section following the Action Plan. Management's response is set out in its entirety in Appendix A.

ACTION PLAN

| No. | Management Response |
|-----|---|
| 1 | <p>Developing written procedures for the processing of invoices by staff in the Facilities Maintenance Division would improve controls.</p> <p>Management Response: <input checked="" type="checkbox"/> Agree <input type="checkbox"/> Disagree</p> <p>Proposed Resolution or Reason for Disagreement: The Facilities Maintenance Division will prepare written procedures for the processing of invoices pertaining to utility usage at the Scottsdale Center for the Performing Arts.</p> <p>Responsible Party: Don Penfield Facilities Maintenance Division</p> <p>Completed By: December 2007</p> |
| 2 | <p>The percentage used to allocate water/sewer utility expense between the City and the Cultural Council is not supported with written documentation; the allocation may not be fair or equitable.</p> <p>Management Response: <input checked="" type="checkbox"/> Agree <input type="checkbox"/> Disagree</p> <p>Proposed Resolution or Reason for Disagreement: At its April 27, 2007 meeting, the Joint Task Force on the Arts expressed satisfaction with the current practice to split the water/sewer utility payment on a 50-50 basis. This split has been documented in the draft of the master agreement between the City and the Cultural Council, which will be considered by the full City Council.</p> <p>Responsible Party: Michelle Korf Downtown Group</p> <p>Completed By: Spring 2008</p> |
| 3 | <p>There is an unidentified balance being carried forward in the account used by the City to record amounts due from the Cultural Council.</p> <p>Management Response: <input checked="" type="checkbox"/> Agree <input type="checkbox"/> Disagree</p> <p>Proposed Resolution or Reason for Disagreement: Accounting Division staff reconciled the account and determined that payments were received for all amounts billed through the City's miscellaneous accounts receivable system. Additional activity was recorded in this account prior to fiscal year 2002-2003. This activity comprises the outstanding balance. We were not able to research this activity due to Record Retention policies. Procedures have been implemented to write-off the outstanding balance and to reconcile the account monthly.</p> <p>Responsible Party: Richard D. Chess Financial Services</p> <p>Completed By: Completed</p> |

| No. | Management Response |
|-----|--|
| 4 | <p>Strengthening the monitoring process currently used by the Contract Administrator would improve controls.</p> <p>Management Response: <input checked="" type="checkbox"/> Agree <input type="checkbox"/> Disagree</p> <p>Proposed Resolution or Reason for Disagreement: As verification of the SmartStream Receivable reports forwarded to the Contract Administrator each month, the written procedures addressing the allocation and invoicing for utility usage at the Scottsdale Center for the Performing Arts will include a provision that requires copies of monthly utility invoices be sent to the Contract Administrator.</p> <p>Responsible Party: Michelle Korf Downtown Group Don Penfield, Community Services</p> <p>Completed By: December 2007</p> |
| 5 | <p>The City has not been billing the Cultural Council for any share of the cost of natural gas usage at SCPA.</p> <p>Management Response: <input checked="" type="checkbox"/> Agree <input type="checkbox"/> Disagree</p> <p>Proposed Resolution or Reason for Disagreement: This was brought to the attention of the Joint Task Force on the Arts at its April 27, 2007 meeting. Staff has taken steps to initiate this billing on a 50%-50% basis, and to memorialize this division in the new master agreement between the City and the Cultural Council. Procedures have been implemented to bill the Scottsdale Cultural Council for the natural gas utility expense effective July 1, 2007.</p> <p>Responsible Party: Richard D. Chess Financial Services</p> <p>Completed By: Completed</p> |
| 6 | <p>Collection of recyclable materials generated by a non-profit agency is occurring without a charge for this service. City Code does not incorporate this policy.</p> <p>Management Response: <input checked="" type="checkbox"/> Agree <input type="checkbox"/> Disagree</p> <p>Proposed Resolution or Reason for Disagreement: The City Council will be asked to consider a policy that provides for the collection of recyclable materials at no cost to Scottsdale's non-profit organizations.</p> <p>Responsible Party: Rick Pence Municipal Services</p> <p>Completed By: Spring/Summer 2008</p> |

| No. | Management Response |
|-----|---|
| 7 | The methodology used to allocate the cost of electrical service at the SCPA building has been in place for at least ten years. During this time, no energy audit has been undertaken. |
| | <p data-bbox="360 470 1089 504">Management Response: <input checked="" type="checkbox"/> Agree <input type="checkbox"/> Disagree</p> <p data-bbox="360 514 1429 646">Proposed Resolution or Reason for Disagreement: An energy audit will be completed approximately twelve months after the completion of the renovation of the Scottsdale Center for the Performing Arts, when sufficient energy usage data has been accumulated.</p> <p data-bbox="360 688 1289 753">Responsible Party: Michelle Korf Downtown Group Completed By: FY 2011</p> |

RESULTS

The audit was completed using the following criteria:

- Section 2.10 of the MSA.
- City Code, Chapter 24, "Solid Waste Management."
- Generally accepted accounting practices.

Audit work was conducted in compliance with generally accepted auditing standards as they relate to expanded scope auditing as required by Article III, Scottsdale Revised Code, §2-117, *et seq.* Stuart Posner and Cheryl Dreska were the assigned auditors. The following 10 condition statements set out the results of observations, interviews, and tests of compliance.

The City allocates the cost of electricity and water/sewer service provided to the SCPA building and bills the Cultural Council for their portion.

Condition: Calculations were correct and written procedures are available for use by staff in the Financial Services Department responsible for ensuring that the Cultural Council is billed for electricity and water/sewer service.

Cause: Established procedures.

Effect: Reasonable assurance of compliance with requirements.

Electricity, water/sewer, and natural gas utilities for the SMOCA building are billed directly to the Cultural Council, therefore, there is no need to allocate the cost of this service.

Condition: Accounts for electricity, water/sewer, and natural gas service to the SMOCA building are held in the name of the Cultural Council and billed directly.

Cause: Established procedures.

Effect: Compliance with contractual requirements; no need to bill the Cultural Council for these utilities.

There is no commercial service for solid waste collection at the SCPA building, therefore, there is no need to allocate the cost of this service.

Condition: Non-recyclable refuse from the Cultural Council side of the SCPA building is placed in a compactor behind a neighboring business. The Cultural Council is billed routinely for one-half of the standard cost for a compactor of the size used for this service.

Cause: No space is available for commercial collection containers in the proximity of the SCPA building so other areas are used.

Effect: No need to charge for an allocation of this utility.

Developing written procedures for the processing of invoices by staff in the Facilities Maintenance Division (FMD) would improve controls.

Condition: Written procedures do not exist to provide historical knowledge of the allocation of the cost of electricity for the SCPA building or the process to follow when submitting the invoices for electrical service for payment.

Cause: Processing the invoices for electrical service is a long standing function and staff is familiar with the process; competing demands for time and other priorities can foster an environment that does not reinforce the need for written procedures.

Effect: Internal control weakness. Failure to create and maintain written procedures for routine functions creates a risk that historical knowledge of the practice will be lost if there is staffing turnover.

The percentage used to allocate water/sewer utility expense between the City and the Cultural Council is not supported with written documentation; the allocation may not be fair or equitable.

Condition: Neither the Contract Administrator nor staff in the FMD could provide documentation supporting the percentage currently used to allocate the cost of water/sewer service. According to FMD management, the allocation was set in 2004 after consultation with staff from Accounting, Utility Billing, and the current Contract Administrator. This date corresponds with other information that

indicates that the City started billing the Cultural Council for water/sewer consumption in 2004.¹

Cause: The Contract Administrator stated that the cause is unknown.

Effect: Failure to justify and document the allocation methodology creates a risk that one party will bear more than their fair share.

There is an unidentified balance being carried forward in the account used by the City to record amounts due from the Cultural Council.

Condition: The clearing account used to record the amount due from the Cultural Council when the Arizona Public Service (APS) bill is processed does not reconcile. There is an unidentified balance forward of \$15,873.86 that was traced back to the end of fiscal year ending June 2004.

Cause: We made a request to staff in the Financial Services Department for the cause of this condition and did not receive a response before issuance of the report.

Effect: Internal control weakness. Failure to reconcile receivable accounts at least annually creates a risk that an amount will remain uncollected or an error will remain undetected.

Strengthening the monitoring process currently used by the Contract Administrator would improve controls.

Condition: Each month, a copy of the SmartStream Receivable is forwarded to the Contract Administrator to facilitate monitoring of the billing and payment. The Contract Administrator does not verify the allocation.

Cause: The Contract Administrator has been working on improvements in oversight. The need to verify the calculation had not been identified and addressed as yet.

Effect: Internal control weakness. Failure to implement a detective control at the Contract Administrator level creates a risk that an error in calculation or billing will remain uncaught.

¹ The Cultural Council was billed for three years of expenditures in 2004. Failure to bill for water was raised in audit reports dated 1990 and 1993.

The City has not been billing the Cultural Council for any share of the cost of natural gas usage at SCPA.

Condition: There is no process in place to bill the Cultural Council for the appropriate share of natural gas usage. Total cost of this service for the twelve month period ending June 2007 was \$21,136.03.²

Cause: The Contract Administrator stated that the cause is unknown.

Effect: Non-compliance with contractual terms. Failure to bill a third party for their share of an expense incurred by the City means that the City absorbs the expense.

Collection of recyclable materials generated by a non-profit agency is occurring without a charge for this service. City Code does not incorporate this policy.

Condition: Recyclable material from the SCPA, SMOCA, and the Cultural Council administrative offices is placed in several City-owned recycling containers placed on the south side of the SCPA building. The containers are rolled to the curb each Wednesday evening for pick-up as part of the regular Thursday morning collection of residential recyclables. There has been no charge for this service.

Cause: According to the Director of the Solid Waste Management Division, it is the policy of the City to not charge for the collection of recyclable materials at non-profit organizations or City facilities. This policy is not incorporated into City Code and, according to the Director, was a management decision in the 1990s.

Effect: Failure to establish fees and bill for the collection of recyclables collected at City facilities and from non-profit organizations creates a situation where rates charged to other solid waste customers may be overstated to cover the cost necessary to collect and transport this material.

² Failure to bill for the portion of natural gas was identified in audit reports issued in 1990 and 1993.

The methodology used to allocate the cost of electrical service at the SCPA building has been in place for at least ten years. During this time, no energy audit has been undertaken.

Condition: There is no record of a City initiated energy audit and no documentation to evidence that consideration was given to the requirement.

Cause: The Contract Administrator stated that she has monitored capital improvement projects at the SCPA building subsequent to her designation as the Contract Administrator in 2004. It is her belief that building modifications have not been significant enough to compel the initiation of an energy audit. She also stated that she has made inquiries of both staff at the Cultural Council and the City's FMD and both groups stated that they are satisfied with the current allocation methodology.

Effect: No evidence to indicate compliance with requirements; one party may be subsidizing the cost of operations for the other party.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective:

Determine compliance with Section 2.10, Utilities, of the MSA.

Scope:

Testing of expenditures was limited to a twenty-four month period ending June 2007. For compliance with the requirement to initiate an energy audit, we inquired about changes to the facility subsequent to the 1997 approval date. Work did not include an examination of compliance with City administrative regulations or other policies. If this work had been completed, we may have become aware of other conditions that are not reported.

Methodology:

To complete this work we:

- Reviewed the MSA provisions relating to the responsibilities of each party as they relate to the cost of utilities at managed facilities.
- Made inquiries to the Contract Coordinator and staff from the Cultural Council and walked through both the SCPA and SMOCA buildings to obtain an understanding of the layout of the facilities.
- Sought information on actions that would have triggered the requirement for an energy audit and obtained a list of improvements to the City's computer operation center completed in the last ten years.
- Interviewed staff in the:
 - Accounting Division of the Financial Services Department
 - Facilities Maintenance Division of the Community Services Department
 - Solid Waste Management Division of the Municipal Services Department
- Obtained documentation from the City's geographic information system (GIS) on the location of electrical, gas, and water meters serving the SCPA and SMOCA buildings and conducted field observations to compare the meters found to those set out by staff in the FMD as servicing these buildings.

Audit testing included:

- Verifying the amount billed to the Cultural Council for electricity. We obtained copies of APS invoices for the twenty-four month period ending June 2007, determined the total charged for service at the SCPA, multiplied the total by 50 percent, and then traced the amount to the City's trial balance and the SmartStream receivables account.

- Recalculating the amount billed to the Cultural Council for water/sewer service. We obtained twenty-two months of data from the City's Utility Billing system for the two meters located at the SCPA building. For ten months ending February 2007 and four random months from the twelve month period ending February 2006, we multiplied each monthly total by 50 percent and traced the amount to the SmartStream receivables system.
- Obtaining copies of invoices for the meters associated with the SMOCA building to verify that the accounts were held in the name of the Cultural Council and copies of the invoices for the monthly solid waste disposal to ensure that the City was not paying for this service.
- Reviewing procedures used by staff in the Accounting Division to bill the Cultural Council for electricity and water/sewer costs to ensure that there was reasonable assurance that the process would survive staff turnover.
- Reconciling the year-to-date account activity for the receivable account 13552 for the fiscal years ending June 2005, 2006, and 2007 to verify the accuracy of the offsetting entries when the SmartStream receivable is created.

We also obtained copies of invoices for natural gas service at the SCPA building for the two fiscal years ending June 2006 and 2007. This information was used to calculate the lost revenue associated with the failure to bill for this service.

Finally, we obtained information on the square footage of the SCPA building from the Project Manager assigned to the SCPA remodeling project currently underway. This information was used in the background section of the report.

BACKGROUND

Under the terms of the MSA, the Cultural Council is responsible for managing, operating, and programming any facility the City designates as a "managed facility." Currently, only two facilities fall within this category; the SCPA (referred to as the Scottsdale Center for the Arts in the MSA) and SMOCA.³ The SCPA is a rectangular shaped, multi-storied building with approximately 88,600 square feet under roof. The City's Information Systems Department and computer operations center occupies approximately 27 percent, the Cultural Council has control of approximately 55 percent, and approximately 18 percent is shared space such as storage and HVAC. The SMOCA building is located immediately west of the SCPA and is used exclusively by the Cultural Council.

Responsibility for the cost of utilities at managed facilities, other than the SMOCA building, is to be split between the City and the Cultural Council based on occupancy. The City is to initiate an energy audit at any managed facility if a building modification or other change in use occurs; if the audit shows a change in consumption pattern, the allocation of cost is to change. Both parties have the right to request an energy audit at any time for any managed facility to determine if the allocation should be changed. The cost of the audit is to be paid by the requesting party.

There are several types of utility services necessary to service the SCPA. Electricity is provided by APS and natural gas is provided by Southwest Gas; both accounts are under the City's name. Water and sewer costs are billed by the City to an account in the name of the City. Currently, there is no commercial refuse pick up at the building. Janitorial staff, cleaning the City's side of the building, dump refuse in a container behind the City owned building at the southwest corner of Second Street. Non-recyclable refuse from the Cultural Council's side of the building is dumped in a compactor behind a privately owned building in the vicinity of the SCPA. Recyclable materials from the Cultural Council portion of the SCPA, the SMOCA, and other Cultural Council administrative offices are placed in several residential size recyclable materials containers for collection by staff from the City's Solid Waste Management Division as part of the regular collection of recyclable materials.

In 1997, when the MSA was restated, both parties agreed that the cost of electricity for the building should be split equally and this is currently the

³ In the MSA, this facility is referenced as the PAVILION or the Scottsdale Museum of Contemporary Art, Gerald L. Cafesjian Pavilion.

practice. For fiscal year ending June 2007, the electricity cost for the SCPA totaled slightly less than \$268,917 (an average of \$22,400 per month).

The agreement is silent on the methodology to be used to allocate the cost for other utilities. For the fiscal year ending June 2007, the cost of natural gas usage at SCPA was slightly more than \$21,100 (an average of \$1,750 per month) and the cost of water/sewer service was approximately \$12,829 (an average of \$1,069 per month).

APPENDIX A – MANAGEMENT RESPONSE

Memorandum



To: Cheryl Dreska, City Auditor
From: Michelle Korf, Downtown Group
Date: October 11, 2007
Re: Cultural Council Agreement: Utilities Audit Report 0510C.1

Thank you for your recommendations regarding compliance with Section 2.10 Utilities in the master agreement between the City and the Scottsdale Cultural Council.

As you know, the Joint Task Force on the Arts was formed, in part, to address the renewal of this contract. Please be assured that the recommendations contained in this report will be included as part of the discussion to update this agreement.

cc: John Little, Executive Director
Craig Clifford, Finance General Manager
Deb Baird, Community Services General Manager
Dan Worth, Municipal Services General Manager